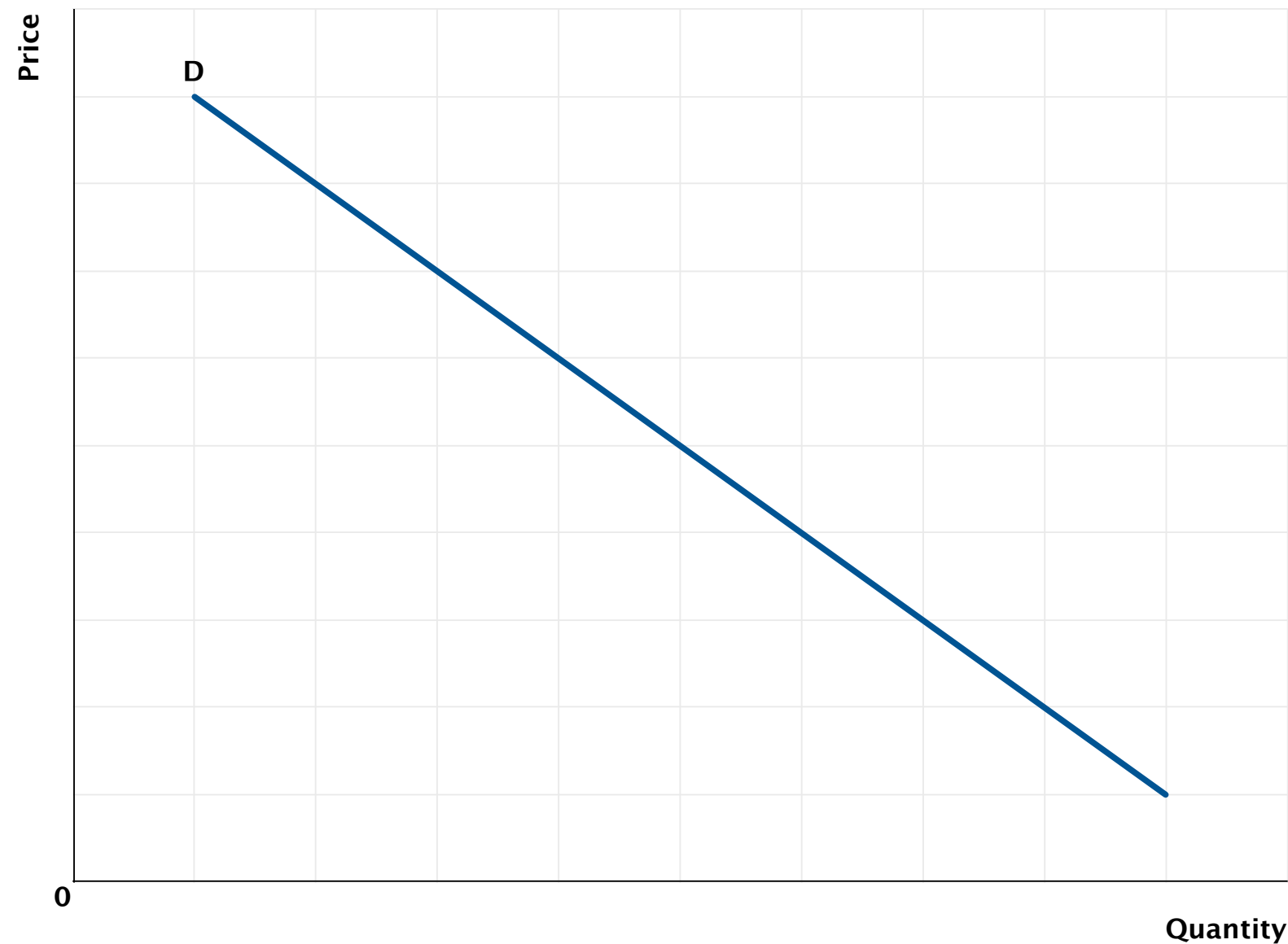


# Aggregate Demand

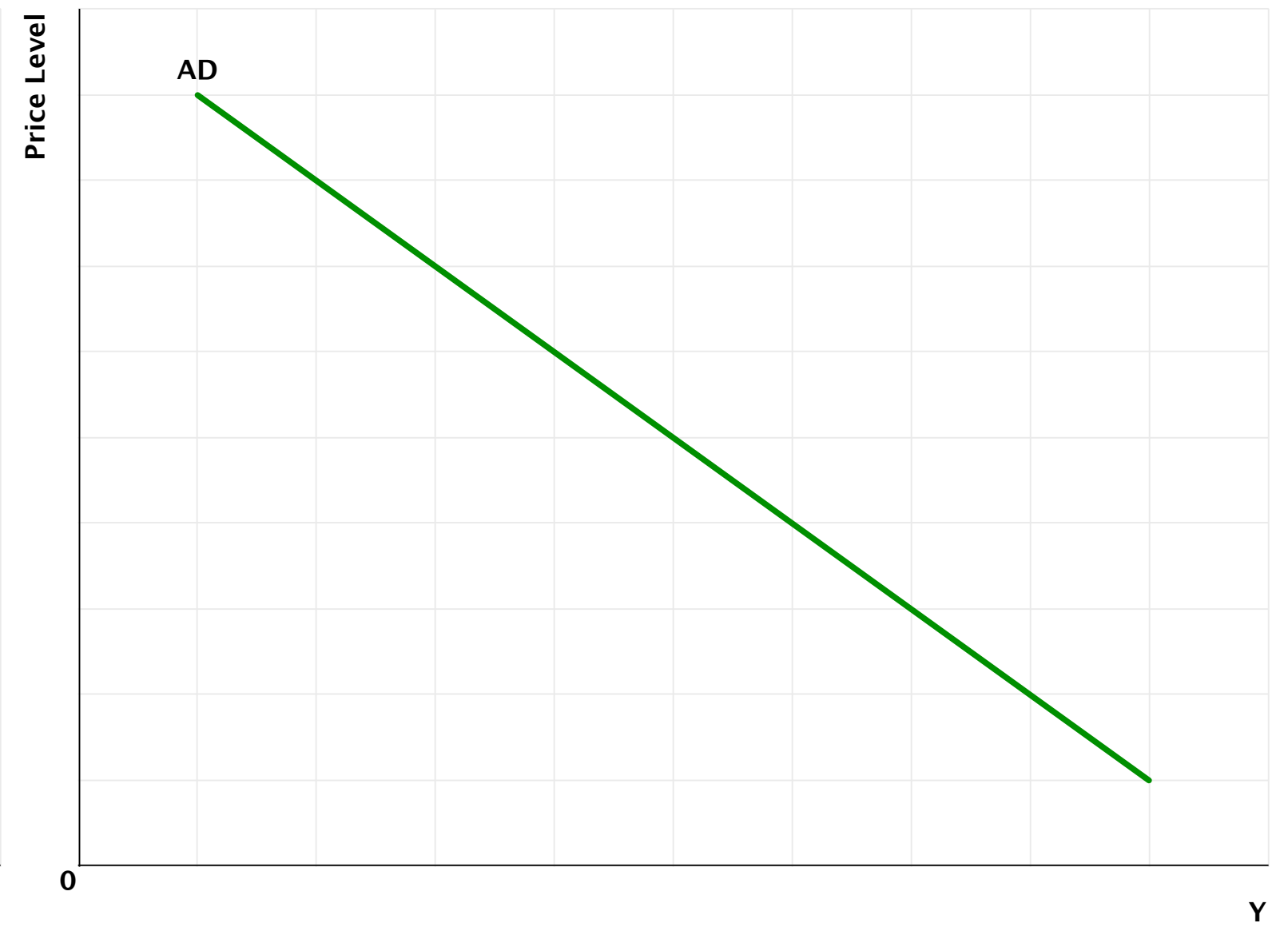
The demand of the entire economy

- **Aggregate demand:** the total quantity of all goods and services demanded (purchased) at different price levels

- **Aggregate demand** (a macro concept) looks very similar to **demand** from micro, but with some important differences:



**DEMAND**



**AGGREGATE DEMAND**

## Demand

Demand is concerned with one good or service.

Demand uses price on the Y axis.

Demand uses quantity on the X axis.

## Aggregate Demand

Aggregate demand is concerned with all goods and services.

Aggregate demand uses price level on the Y axis.

Aggregate demand uses real output/real income/Y on the X axis.

## Demand

As price  $\uparrow$ ,  $Q_D \downarrow$  and vice versa.

A  $\Delta$  in  $D$  means the entire curve moves left or right.

A  $\Delta$  in  $P$  means we move along the curve.

## Aggregate Demand

As price level  $\uparrow$ ,  $Y \downarrow$  and vice versa.

A  $\Delta$  in  $AD$  means the entire curve moves left or right.

A  $\Delta$  in  $PL$  means we move along the curve.

- Aggregate demand is the same as real GDP.
- $GDP = C + I + G + X - M$  (the expenditure method)
- Therefore,  $AD = C + I + G + X - M$
- Anything that changes C, I, G, X, and/or M changes AD.

# Consumption

- The total spending by consumers on domestic goods and services.
- **Durable goods:** items used by consumers over a period of at least one year.
- **Non-durable goods:** items used by consumers over a period less than one year.

# What causes a $\Delta$ in consumption?

- $\Delta$  in income
- $\Delta$  in interest rates
- $\Delta$  in wealth
  - $\Delta$  in house prices
  - $\Delta$  in the value of stocks and shares
- $\Delta$  in expectations / consumer confidence



# Investment

- The addition of capital stock to the economy.
- Investment is carried out by firms.
  - **Replacement investment:** when firms spend on capital in order to maintain the productivity of their existing capital.
  - **Induced investment:** when firms spend on capital to increase their output to respond to higher demand in the economy.

**Investment is not buying shares or putting money in the bank!!!**

That stuff is actually **savings**, which is a leakage from the circular flow.

# What causes a $\Delta$ in investment?

- $\Delta$  in interest rates
- $\Delta$  in national income
- $\Delta$  in technology
- $\Delta$  in expectations / business confidence

# Government spending

- Expenditures made by the government (federal, state, provincial, etc.)
- Includes health, education, law enforcement, infrastructure, defense, etc.

# What causes a $\Delta$ in government spending?

- $\Delta$  in government policies
  - $\Delta$  in **fiscal policy**
  - $\Delta$  in **monetary policy**

# Fiscal Policy

- Government's use of taxing and spending to influence the economy.
- **Expansionary fiscal policy** ↓ taxes and ↑ government spending in order to ↑ AD.
- **Contractionary** (or deflationary or restrictive) **fiscal policy** ↑ taxes and ↓ government spending in order to ↓ AD.

# Monetary Policy

- Government's control of the money supply and interest rates.
  - **Expansionary** (or loose) **monetary policy** ↓ interest rates in order to ↑ AD.
  - **Contractionary** (or tight) **monetary policy** ↑ interest rates in order to ↓ AD.

# Net exports

- Exports: domestic goods or services that are bought by foreigners.
- Imports: goods or services bought from foreign producers.
- $(X - M)$
- A negative number means there are more imports than exports, and  $AD \downarrow$ .
- A positive number means there are more exports than imports, and  $AD \uparrow$ .



# What causes a $\Delta$ in exports?

- $\Delta$  in foreign incomes
- $\Delta$  in the growth of foreign economies
- $\Delta$  in countries' trade policies
- $\Delta$  in countries' currency values (exchange rates)
- $\Delta$  in countries' inflation rates

# What causes a $\Delta$ in imports?

- $\Delta$  in domestic income
- $\Delta$  in countries' trade policies
- $\Delta$  in countries' currency values (exchange rates)
- $\Delta$  in countries' inflation rates